

## Shell and Shadow: Navigate the Hidden Tax in Indonesia and Germany

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### ABSTRACT

Reduced tax revenues, distortion of competition, reduced investment, reduced economic growth, and social inequality are serious impacts of the existence of the shadow economy. The existence of shell companies and the shadow economy form a causal relationship. Indications that shell companies are facilitators of shadow economy activities as well as tax avoidance tools become a crucial discussion to find out what should be improved in the context of transparency and supervision. This article aims to establish a view on the existence of shell companies under both Indonesian and German law. This article will explore the definition of shell companies and the implications of different interpretations of shell companies for the formulation of regulations on the shadow economy in Indonesia and Germany and will present an analysis of the existence of shell companies as a form of shadow economy activity that has a negative impact on the country's economy. This issue is the basis for introducing aspects of the strength of tax law in Germany to Indonesia.

**Keywords:** shadow economy, shell company, shell company, tax avoidance.

### INTISARI

Pengurangan pendapatan pajak, distorsi persaingan, pengurangan investasi, pengurangan pertumbuhan ekonomi, serta ketimpangan sosial merupakan dampak serius yang hadir dari eksistensi shadow economy. Eksistensi perusahaan cangkang dan *shadow economy* membentuk suatu hubungan kausalitas. Indikasi bahwa perusahaan cangkang merupakan fasilitator kegiatan shadow economy serta alat penghindaran pajak menjadi suatu pembahasan yang krusial untuk mengetahui hal yang harus diperbaiki dalam konteks transparansi dan pengawasan. Artikel ini bertujuan untuk menetapkan pandangan terkait dengan eksistensi perusahaan cangkang dilihat dari sisi hukum Indonesia maupun sisi hukum Jerman. Artikel ini akan menelusuri definisi terkait dengan perusahaan cangkang dan implikasi perbedaan penafsiran perusahaan cangkang kepada perumusan regulasi mengenai shadow economy di Indonesia dan Jerman serta akan disajikan analisis eksistensi perusahaan cangkang sebagai salah satu bentuk dari kegiatan shadow economy yang berdampak cenderung negatif pada perekonomian negara. Isu ini menjadi landasan agar terjadi induksi aspek-aspek kekuatan hukum pajak di Jerman ke Indonesia.

**Kata kunci:** Shadow economy, shell company, perusahaan cangkang, penghindaran pajak.

## INTRODUCTION

Coming up with an accurate definition of the shadow economy is complicated, as is determining the scale of its activities and how much the state loses due to them. One of the most complicated challenges in economic phenomena is providing an accurate and comprehensive definition of the shadow economy. This phenomenon, which reflects economic activity that is not regulated or formally disclosed to the government, such as illegal transactions or trade in goods and services without involving reporting and payment of taxes, has long been the subject of intense debate and research in legal and economic circles. The complexity and inherently hidden nature of the shadow economy make it difficult to come up with a firm and sustainable definition of the shadow economy.

The World Bank Document defines the shadow economy more specifically. The shadow economy is defined as activities that are deliberately hidden from public authorities for several reasons, namely:<sup>1</sup>

1. To avoid paying income, value-added, or other taxes;
2. To avoid paying social security contributions;
3. To avoid having to meet certain legal labor market standards, such as minimum wage, maximum working hours, safety standards, etc.,
4. To avoid compliance with certain administrative procedures.

Many terms are equated with the shadow economy, including the underground economy, hidden economy, black economy, gray economy, or unobserved economy.<sup>2</sup> The OECD (Organization for Economic Cooperation and Development) categorizes the shadow economy into four different activities, namely underground production, which can be interpreted as a productive activity that is legal but deliberately hidden from public authorities.<sup>3</sup> The aim is to evade tax provisions and other regulations. Another category is illegal production, which is productive activity that produces goods and services that are prohibited by law. Then another category is informal sector production, which can be interpreted as legal productive activities that produce goods and services on a small scale and are generally carried out by household businesses that are not incorporated. Furthermore, the last category is the production of households for their own final use, which can be interpreted as household production for their own use.

The IMF working paper states several reasons for the existence of the shadow economy, namely monetary reasons, regulatory reasons, and institutional reasons.<sup>4</sup> The monetary reason in this case is to avoid paying taxes and all contributions related to social security. Regulatory

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<sup>1</sup> Rebecca A Zulandt Schneider, Robb WS Schneider and Paul A Moore, 'Recognition of Dominance Status by Chemoreception in the Red Swamp Crayfish, *Procambarus Clarkii*' (1999) 25 *Journal of Chemical Ecology* 781 <<http://ftp.iza.org/dp1431.pdf>>.

<sup>2</sup> UNIVERSITAS SAINS, 'Apa Itu Shadow Economy?|D4 Komputerisasi Akuntansi S.Tr.Kom' (*Stekom.ac.id*2022) <<https://komputerisasi-akuntansi-d4.stekom.ac.id/informasi/baca/Apa-Itu-Shadow-Economy/d97b31e2fed3dcfbaf33f0fb9e23197ea7281a62>> accessed June 2023.

<sup>3</sup> *ibid*

<sup>4</sup> *ibid*

reasons include avoiding government bureaucracy and all the problems that arise as a result of bound regulations, and institutional reasons are related to anti-corruption laws, the quality of political institutions, and the weak rule of law.

From the explanation, the definition of shadow economy can be interpreted as activities that are carried out legally or illegally and contribute to GDP (Gross Domestic Product) and GNP (Gross National Product), but these activities are completely unrecorded and unaccounted for. The economic performance of a country is usually determined by its GDP (Gross Domestic Product). GDP refers to the sum of goods and services produced by units of production in a country over one year. This means that GDP covers the total income earned nationally. This income comes from both citizens and foreigners living within the country. GNP refers more to the total value of goods and services produced by its citizens, both citizens living in the country's territory and abroad with a calculation period of one year.<sup>5</sup> Activities in the shadow economy are not officially reported to the government. This means that most of the income and production from shadow economy activities are not recorded in the official GDP calculation. This has implications for the reported GDP to be lower than it is. This is what makes the existence of the shadow economy troubling. The Shadow economy will make the GDP (Gross Domestic Product) data biased, potentially create a loss of tax potential, and lead to losses in the country's economy. Covert and undetected shadow economy activities are vulnerable to escaping the supervision of state tax authorities. This leads to the release of tax obligations that should be paid by the perpetrators of shadow economy activities. In terms of data, the existence of a shadow economy makes data in the country's economic sector biased and has implications for state policy-making in the economic sector, which is difficult and not as well structured as it should be. This is not least due to information bias in terms of some economic indicators such as the unemployment rate, labor force, and data on income being inaccurate. In terms of competition in job searches, the shadow economy has the potential to make job seekers interested in joining it. This is what causes State losses in terms of violations of the rules as well as potential tax revenue.

There are several examples of activities related to the shadow economy, one of which is the efforts of individuals or business entities, either independently or in collaboration with the competent authorities, not to fulfill tax obligations, which in this case takes advantage of the gray area in laws and regulations to carry out tax avoidance. or tax evasion, or can be said to have committed a tax crime intentionally (tax evasion). Shell companies are a phenomenon that raises public concern because, in general, they are used as a means of avoiding tax obligations and storing assets resulting from illegal activities carried out abroad. The dark side of the shell company appears in the avoidance of taxpayer obligations. The method that is often used is to transfer the profits of overseas affiliated companies to domestic shell companies.<sup>6</sup> This is done in order to manipulate the financial statements of affiliated companies, which results in a lack of

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<sup>5</sup> admin blog, 'Perbedaan GDP & GNP; Pengertian, Konsep Dan Cara Menghitungnya' (*Blog Pasar Modal* 5 March 2021) <<https://blog.pasarmodal.univthamrinaka.com/perbedaan-gdp-pengertian-konsep-dan-cara-menghitungnya/>> accessed February 2024.

<sup>6</sup> Mochamad Januar Rizki, 'Sisi "Gelap" Kiprah Perusahaan Cangkang' (*hukumonline.com* 4 October 2018) <<https://www.hukumonline.com/berita/a/sisi-gelap-kiprah-perusahaan-cangkang-lt5bb5c0dad0a85/?page=2>> accessed June 2023.

affiliated company tax values because the profits have been partially transferred to shell companies. This kind of dark side potential then becomes a concern and an issue in society that needs to be studied from a legal perspective in order to achieve legal certainty.

## METHODS

This journal addresses three main issues. The author aims to establish a view on the existence of shell companies under both Indonesian and German law. The author will explore the definition of a shell company and whether the difference in definition has implications for the formulation of regulations on the shadow economy in Indonesia and Germany. The author will present an analysis of why shell companies in Indonesia still exist, even though shell companies are a form of shadow economy activity that has a negative impact on the country's economy. After analyzing the issue, the author will provide solutions for amendments in our regulations to bring aspects of the strength of tax law in Germany to Indonesia.

The normative method is used to structure this research. This research is structured with comparative law, with the author trying to answer the urgency and possibility for Indonesia to induce aspects of the power of tax law in addressing shell companies as one of the shadow economy's activities. This article is written with the method of literature study and normative juridical research because this research has the vision and mission of obtaining legal knowledge between laws by studying laws and regulations that are not only Indonesian laws but also those of other countries that can be taken as positive values.

## QUESTIONS

1. How do Indonesia and Germany define 'shell companies' in developing shadow economy legislation?
2. How is the implementation of taxes on shell companies in Indonesia and Germany?
3. What are the differences between Indonesian and German regulatory viewpoints on dealing with shell corporations as part of the shadow economy's activities?

## RESULTS AND DISCUSSION

### 1. Definition of Shell Company in Indonesia and Germany

A shell company is also known as an SPV (Special Purpose Vehicle).<sup>7</sup> Shell companies are often synonymous with potentially unlawful business activities, especially in terms of tax avoidance. Shell companies are widely used as a tool to divert the profits of affiliated companies abroad. This intends to cover the profits earned by the affiliated company so that it will reduce the taxable value of the affiliated company.

The definition of a shell company in Indonesia is contained in Article 2 paragraph (4) of Minister of Finance Regulation Number 127/PMK.010/2016 on Tax Amnesty

<sup>7</sup> Erizka Permatasari S.H and Hukumonline, 'Mengenai Perusahaan Cangkang Dan Potensi Penyalahgunaannya' (www.hukumonline.com 7 July 2018)

<<https://www.hukumonline.com/klinik/a/mengenai-perusahaan-cangkang-dan-potensi-penyalahgunaannya-lt607e98841fa61>> accessed February 2024.

Based on Law Number 11 Year 2016 on Tax Amnesty for Taxpayers Owning Indirect Assets Through Special Purpose Vehicles. This regulation defines a shell company as a company established solely to carry out a special or specific function for the benefit of its founder and does not conduct active business activities. The criteria for identifying shell companies used by the Organization for Economic Co-operation and Development (OECD) are contained in the OECD Benchmark Definition of Foreign Direct Investment, Fourth Edition. The criteria are as follows:<sup>8</sup>

1. The company is legally formed and officially registered and is subject to tax obligations and other economic laws in the place where the legal entity is domiciled;
2. The company is controlled by a parent company domiciled outside the jurisdiction of the legal entity, either directly or indirectly;
3. The company has few or no employees, no business activities, and no physical presence;
4. Almost all of the company's assets are investments in or from other countries;
5. The core business of the company consists of group holding or financing activities, with a system of channeling funds from non-residents to other non-residents.

When viewed from the perspective of legality, shell companies in Indonesia are legally recognized in Indonesia. Shell companies, in the eyes of Indonesian law, are categorized as permanent Establishments (BUT). Article 2 paragraph (5) of Law Number 36 of 2008 concerning the Fourth Amendment to Law Number 7 of 1983 concerning Income Tax defines a permanent Establishment as a form of business used by individuals who do not reside in Indonesia, people who live in Indonesia within a period of less than 183 (one hundred and eighty-three) days for a period of 12 (twelve) months, as well as entities that are not established and domiciled in Indonesia to carry out a business or carry out activities in Indonesia.<sup>9</sup>

There are several types of Permanent Establishment (BUT), namely:<sup>10</sup>

- a. Management domicile;
- b. Branch company;
- c. Representative office;
- d. Office building;
- e. Factory;
- f. Workshop;
- g. Warehouse;
- h. Space for promotions and sales;
- i. Mining and excavation of natural resources;
- j. Oil and gas mining working areas;

<sup>8</sup> *ibid*

<sup>9</sup> Law Number 36 of 2008 on the Fourth Amendment to Law Number 7 of 1983 concerning Income Tax., Article 2 paragraph 5.

<sup>10</sup> Law Number 36 of 2008 on Income Tax, Article 2 paragraph 5.

- k. Fishery, animal husbandry, agriculture, plantation, or forestry
- l. Construction, installation, or assembly projects;
- m. Provision of services in any form by employees or other people, as long as they are carried out for a period of more than 60 (sixty) days within a period of 12 (twelve) months;
- n. Person or body acting as an agent whose position is not independent;
- o. Agents or employees of insurance companies that are not established and domiciled in Indonesia who receive insurance premiums or incur risks in Indonesia, as well as;
- p. Computers, electronic agents, or automated equipment owned, rented, or used by electronic transaction operators to carry out business activities via the internet.

From a tax perspective, shell companies are seen as special-purpose vehicles. This is regulated in the regulation of the Minister of Finance No. 258/PMK.03/2008 for the year 2008 on Income Tax Withholding Article 26 on income from the sale or transfer of shares referred to in Article 18 paragraph (3C) of the Income Tax Law received or acquired by foreign taxpayers. Article 1 Paragraph (2) of this regulation defines an SPV (Special Purpose Vehicle) as an "intermediate company" created for the purpose of selling or transferring shares of a company incorporated or domiciled in a tax haven country that has a special relationship with an entity incorporated or domiciled in Indonesia or a permanent establishment in Indonesia.<sup>11</sup>

In broad terms, the essence of defining a shell company lies in a company that lacks activities or can be considered a company only on paper, merely existing in name without a physical office. Due to their nature, shell companies are closely associated with legal violations such as concealing funds from illegal businesses, money laundering, and tax evasion. Shell companies are not inherently illegal, but the misuse of their existence is a subject of public debate and requires crucial monitoring of their activities. The advantage of having a shell company lies in the separation of assets between the owner's assets and those of the Special Purpose Vehicle (SPV). This can be advantageous because if the owner of the SPV is declared bankrupt, it will not have an impact on the SPV itself, and vice versa. This reflects the presence of extra protection for assets owned by both the owner and the SPV. Additionally, the liability of the SPV owner is limited to the amount of capital invested in the SPV. The existence of asset limitations and liability restrictions allows shareholders to determine the maximum potential loss of their investment in a company. This has implications for the ease of calculating the costs associated with corporate oversight. Furthermore, by being able to estimate potential losses, shareholders can more easily make investment decisions in multiple companies simultaneously, allowing for more optimal investment diversification.<sup>12</sup>

Considering the potential benefits amidst diverse paradigms in society regarding shell companies, the establishment of an SPV also has positive impacts within it, despite the potential

<sup>11</sup> NNP, 'Begini Hukum Indonesia Memandang Perusahaan "Cangkang"' (*hukumonline.com* 8 April 2016) <<https://www.hukumonline.com/berita/a/begini-hukum-indonesia-memandang-perusahaan-cangkang-lt5707dd59b9f3c/>> accessed June 2023.

<sup>12</sup> Erizka Permatasari S.H, op.cit.

for legal violations associated with criminal activities and the rampant potential for misuse. This becomes an interesting issue when viewed from the aspect of tax implementation on shell companies in Indonesia, which will be discussed in the following subsection after addressing the true definition of shell companies from the perspective of German law.

In German law, a shell company is referred to as "mantelgesellschaften" or "leere gesellschaften," while a limited liability company, commonly known as a GmbH (Gesellschaft mit beschränkter Haftung), is often used to establish a shell company. The term "shell company" is considered ambiguous, and it often refers to activities or phenomena that occur within it, such as a company without commercial activities, a company without business operations, a company aimed at managing its own assets, a company without tangible assets, or a financially weak corporation. It can also refer to a corporation with a falsely stated capital, a corporation lacking organization, or even a corporation without a legal domicile.<sup>13</sup>

A study conducted in 2018 by the European Parliamentary Research Service, commissioned by the European Parliament's Special Committee on Financial Crimes, Tax Evasion, and Tax Avoidance (TAX3), categorized shell companies into three main types: anonymous shell companies, letterbox companies, and special purpose entities.<sup>14</sup> Anonymous shell companies are characterized by a lack of information regarding their purpose and the benefits of their establishment. These anonymous entities are often associated with high-income individuals seeking to evade taxes, but they are also frequently used by criminals for money laundering purposes. Letterbox companies, on the other hand, refer to companies that register their legal entity in one member state but carry out their economic activities in another member state. These types of companies aim to avoid specific labor regulations or circumvent regulations related to social security contributions. Another type of shell company is the special purpose entity (SPE), which is primarily engaged in financing groups or can be interpreted as a holding company. The assets and liabilities of these entities are largely investments in other countries. They typically have very few or no employees. The establishment of these entities is often intended to facilitate aggressive tax avoidance strategies. Although there are various differences among the defined types of shell companies in the research, shell companies can generally be understood as entities that have no activities in the member state of their registration, have few or no employees, or lack a physical presence in the country of their registration. The asset securitization process collaborates with various parties such as the loan originator (the initial creditor, the asset owner), SPV, investors, and so on. SPV is a company established specifically to support the process of asset securitization. This company acts as an institution that buys the originator's receivables (assets) to further make the receivables as collateral in the issuance of securities such as securities to investors. Some functions of SPV in asset securitization are as a special vehicle for the originator to transfer its assets into liquid securities that can be sold to

<sup>13</sup> Markus Vischer, LI Rechtsanwalt and Walder Wyss, '2 Duri F. PraDer, Die Vorrats-Oder Mantelgesellschaft Im Schwei-Zerischen Aktienrecht' (2013) 74 Mantel- und Vorratsgesellschaften <[https://www.walderwyss.com/user\\_assets/publications/1309.pdf](https://www.walderwyss.com/user_assets/publications/1309.pdf)> accessed June 2023.

<sup>14</sup> Pieter Baert, 'BRIEFING EU Legislation in Progress' (2023) <[https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733648/EPRS\\_BRI\(2022\)733648\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733648/EPRS_BRI(2022)733648_EN.pdf)> accessed June 2023.

investors, to protect asset securitization investors from SPV bankruptcy, and to protect the asset securitization itself from the originator's creditors.<sup>15</sup>

## 2. Implementation of taxes on shell companies in Indonesia and Germany

Article 1, paragraph 1, of Law Number 28 of 2007 on the Third Amendment to Law Number 6 of 1983 Regarding General Provisions and Taxation Procedures defines tax as a compulsory contribution to the state imposed by individuals or legal entities based on the law, without receiving direct compensation, and used for the benefit of the state in achieving the maximum welfare of the people.<sup>16</sup> Taxation can be understood as a form of participation by the community, both as individuals and legal entities, that is mandatory and coercive in nature. Tax can also be interpreted as a transfer of wealth from individuals or legal entities, which practically takes the form of money and subsequently receives indirect compensation. The collection of taxes is intended for the optimization of the welfare of the people.

As a formidable legal instrument, taxation embodies an imperative and binding nature that compels legal subjects to fulfill their responsibilities in accordance with prevailing legal norms. In tandem with the dynamics of the global economy and evolving laws, taxation has become a crucial cornerstone within the legal framework governing the relationship between individuals and the state or government, thereby establishing a firm foundation within the intricate realm of national finance. Taxation plays a fundamental role in constructing a nation's economy and significantly contributes to the sustenance of vital public functions. Through the relinquishment of a portion of personal income or wealth to the state, individuals and legal entities are capable of making progressive contributions towards infrastructure development, public services, and other pivotal activities essential to the functioning of a nation-state. Taxation exemplifies the pursuit of social justice, whereby those individuals who have been fortunate in their economic circumstances are expected to share a fair burden in maintaining social harmony.

However, it is essential to recognize that the imposition of taxes entails implications that extend beyond the realm of finance. Taxation, with its inherent power to influence behavior, can incentivize individuals and entities to adopt more sustainable practices, promote responsible consumption patterns, and foster environmental consciousness. By employing tax measures that discourage harmful activities or encourage positive externalities, such as levies on carbon emissions or incentives for renewable energy initiatives, taxation can serve as a powerful tool for steering societal behavior towards a more sustainable and equitable future. Taxation stands as a formidable legal instrument that, while exerting imperativeness and binding force upon legal subjects, also serves as a catalyst for socio-economic progress and collective welfare. Through its multifaceted nature, taxation encompasses the pursuit of social justice, resource redistribution,

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<sup>15</sup> IRFANO ADONIS, 'STATUS PERSONAL SPV DALAM KASUS PENERBITAN SURAT UTANG PIUTANG PT INDAH KIAT PULP & PAPER TBK. (PUTUSAN PENGADILAN BENGKALIS NOMOR 05/PDT.G/2003/PN.BKS)' <<https://lib.ui.ac.id/file?file=digital/2016-9/123661-S26221-Irfano%20Adonis.pdf>>

<sup>16</sup> Law Number 28 of 2007 on the Third Amendment to Law Number 6 of 1983 Regarding General Provisions and Taxation Procedures, Article 1, paragraph 1.



and the promotion of responsible behavior, ultimately contributing to the broader goal of achieving societal harmony and prosperity.

Nevertheless, like a double-edged sword, despite taxes being a vital element in the life of a nation, their existence gives rise to significant implications for individual well-being and alters established patterns of living and consumption within society itself. In line with this understanding, it is crucial to explore the inherent contradictions surrounding the role of taxes in communal life.

Fundamentally, taxes serve as a governmental instrument capable of pooling the necessary funds to finance public needs or activities and maintain economic stability within the state. Taxes act as a bridge connecting individual resources to collective interests. However, it cannot be denied that the obligation to pay taxes can influence the purchasing power of the populace, reducing the available income for personal consumption, investment, or savings.<sup>17</sup> Ultimately, taxes can diminish an individual's capacity to achieve desired standards of living and affect personal prosperity. It is within this context that creative methods have emerged in society to address perceived burdensome tax burdens, one of which is the establishment of shell companies. Shell companies are utilized by business entities primarily with the intention of exploiting loopholes or weaknesses within the tax system to reduce the actual tax liability that should be paid. In practical terms, shell companies often exhibit minimal or even no substantial business activities but are merely employed as vehicles to optimize tax arrangements. Although the purpose of tax existence is theoretically very good, businesses often use shell companies to avoid taxes due to the various complex factors involved in today's global business environment. One of the main reasons is due to the existence of different tax rates between jurisdictions, which allows companies to utilize loopholes in tax laws to reduce their tax burden. In addition, intense global competition encourages companies to look for ways to improve their efficiency and maximize their profits, including by utilizing aggressive tax strategies. The confidentiality and flexibility offered by shell companies are also attractive to businesses that want to keep their business information protected from public scrutiny or competitors.

The strategies employed through shell companies are diverse and involve various tactics, such as income or wealth distribution through subsidiary entities or affiliates in jurisdictions with lighter tax burdens, the utilization of legal loopholes or regulatory ambiguities to evade or reduce tax payments, or even the employment of unreasonable transfer pricing to diminish taxable profits. The utilization of shell company establishment methods to circumvent tax obligations can entail serious legal consequences. The practice of establishing shell companies often involves manipulation or abuse of tax laws, which can be deemed as violations of legal obligations. Therefore, governments and tax authorities frequently take steps to limit such practices, encompassing stricter monitoring and regulatory measures, as well as legal actions against tax evasion.

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<sup>17</sup> Raden Alya Lutfiyyah and Rianda Dirkareshza, 'IMPLIKASI PENDIRIAN PERUSAHAAN CANGKANG DI NEGARA SUAKA PAJAK YANG BERAKIBAT PELANGGARAN PAJAK' (2023) 11 *Kertha Semaya : Journal Ilmu Hukum* 1691 <<https://ojs.unud.ac.id/index.php/kerthasemaya/article/view/99184/50199>> accessed June 2023.

While the existence of taxes plays a vital role in the life of a nation, it is undeniable that their impact can potentially diminish personal prosperity. This has prompted the development of creative methods within society to mitigate perceived burdensome tax burdens, including the establishment of shell companies. However, it is important to recognize that the utilization of such strategies carries significant legal implications. Governments and tax authorities must undertake measures to curtail the practice of establishing shell companies as a means of tax avoidance. These measures encompass heightened scrutiny and regulatory oversight, as well as legal enforcement actions against tax-related violations.

Indonesia adheres to a self-assessment tax system. As mandated by Article 4 of the Income Tax Law (UU PPh), every taxpayer is required to report their income and calculate their taxes without any limitations based on nationality.<sup>18</sup> Thus, the legal obligation to report and pay taxes to the state is unequivocal. Referring to the interpretation of the provisions set forth in the Income Tax Law, it becomes apparent that the key violation does not lie solely in the establishment of shell companies but rather in the failure to report activities in tax filings.

Violations that may arise from the establishment of shell companies are often related to the failure to report the activities of these companies in tax filings. This practice can be seen as an attempt to avoid tax obligations by diverting the profits of affiliated entities abroad to the domestic shell company. Such a method is frequently employed to conceal the profits derived from the affiliated entity. The establishment of shell companies is often exploited to manipulate or falsify the financial reports of affiliated entities. Manipulation of financial reports can result in a reduction in the taxable value of the affiliated entity due to the transfer of profits to the shell company.

Therefore, it is essential to recognize that the crux of the violation lies in the failure to disclose activities and report them accurately in tax filings rather than solely in the establishment of shell companies. The Indonesian tax system places a legal obligation on taxpayers to report all income and calculate their taxes accordingly, irrespective of the nationality or location of the taxpayer. Failure to comply with these requirements, including the non-disclosure of activities and the manipulation of financial reports, can be deemed as violations of tax obligations.

While the establishment of shell companies can potentially facilitate practices that undermine tax obligations, the focus should be on ensuring the accurate reporting of activities and income in tax filings. The misuse of shell companies to manipulate financial reports and transfer profits can lead to the reduction of taxable value and, consequently, the evasion of tax liabilities. The Indonesian tax authorities play a crucial role in enforcing compliance with tax obligations, including monitoring the activities of shell companies and taking appropriate legal actions against violations.

Indonesia has undergone several changes in the implementation of its tax system. Initially, Indonesia applied the semi-self-assessment system and official assessment system, and

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<sup>18</sup> Law Number 36 of 2008 on the Fourth Amendment to Law Number 7 of 1983 concerning Income Tax., Article 4

now it has transitioned to the self-assessment system. The self-assessment system allows taxpayers to independently calculate and determine the amount of tax payable to the government, which is then reported to the tax office where the taxpayer is registered. However, unfortunately, as mentioned earlier in the case of shell companies, the self-assessment system has not been accompanied by sufficient legal awareness among taxpayers, resulting in a high level of tax avoidance. The legal awareness that should be implemented is to run their business by applicable laws and regulations, accurately report all income and financial transactions, and maintain transparency in the company structure. The issues, in addition to the lack of legal awareness among taxpayers, include inadequate supervision and the suboptimal substance of sanctions imposed on non-compliant taxpayers, which fail to effectively deter offenders.

The provisions regarding tax payment in Indonesia can be examined in Article 12 of Law No. 28 of 2007, which states that every taxpayer is obligated to pay the tax due in accordance with the provisions of tax laws and regulations, without relying on a tax assessment letter.<sup>19</sup> Furthermore, the second paragraph of the article elaborates that the amount of tax due according to the tax return (SPT) submitted by the taxpayer is the amount of tax due in accordance with the tax laws and regulations. Moreover, the third paragraph reaffirms that if the Director General of Taxation obtains evidence that the amount of tax due according to the SPT, as mentioned in the second paragraph, is incorrect, the Director General of Taxation will determine the amount of tax due. Despite the implementation of the self-assessment system, the Directorate General of Taxation still conducts tax audits to ensure compliance with tax payment by taxpayers.<sup>20</sup>

The sanctions that can be imposed on individuals who fail to submit the tax return correctly or completely are stipulated in Article 38 of Law No. 28 of 2007. It states that individuals who fail to submit the tax return correctly or completely may be subject to sanctions of up to 2 (two) times the amount of the outstanding tax payable or may be subject to criminal sanctions in the form of imprisonment for a maximum of 1 (one) year.<sup>21</sup> Other criminal sanctions that may be imposed are mentioned in Article 39, paragraph (3) of this legislation, which include imprisonment for a maximum of two years.

In practice, shell companies are often used to hide funds obtained by involving criminal acts. The tactic used by money laundering actors is the transfer of funds to shell companies located outside the jurisdiction of Indonesia. Supervision of shell companies in Indonesia is still very minimal, so this is often a loophole by criminals to commit money laundering loopholes by criminals to commit TPPU (Money Laundering Crime).<sup>22</sup> A case in point is the former Minister of Maritime Affairs and Fisheries, Edhy Prabowo, who is said to have set up a shell company to hold money for alleged bribes to grant lobster seed export licenses. The company prepared to

<sup>19</sup> Law Number 28 of 2007 on the Third Amendment to Law Number 6 of 1983 Regarding General Provisions and Taxation Procedures, Article 12.

<sup>20</sup> Jurnal Al-'adl and Imron Rizki, 'SELF ASSESMENT SISTEM SEBAGAI DASAR PUNGUTAN PAJAK DI INDONESIA' (2018) 11 Jurnal Al-'Adl <<https://core.ac.uk/download/pdf/231140755.pdf>>.

<sup>21</sup> Bisma Wicaksono, 'Indikasi Penghindaran Pajak Dalam Panama Papers' [2016] academia.edu.

<sup>22</sup> Irma Yundira and Demson Tiopan, 'Urgensi Pengawasan Perusahaan Cangkang Sebagai Upaya Penghindaran Tindak Pidana Pencucian Uang Oleh Perusahaan Cangkang Di Indonesia' (2023) 5 Jurnal Hukum dan Pranata Sosial Islam <<https://ejournal.insuriponorogo.ac.id/index.php/almanhaj/article/download/2930/1643/>>.

accommodate the money was PT Aero Citra Kargo (PT ACK).<sup>23</sup> This is according to Decision Number 26/Pid.SusTPK/2021/PN Jkt Pst. This shows that the legality of forming a shell company does not guarantee the legality of its designation.

Germany has a system of tax classes for income taxation purposes. There are six tax classes in Germany, based on marital status. These tax classes determine the tax calculation rules and affect the amount of income tax. Here are the six tax classes in the German tax system:<sup>24</sup>

- a. Tax Class 1: This tax class applies to individuals who are single, widowed, or divorced and do not have any dependents or additional income.
- b. Tax Class 2: This tax class is for single parents who are separated from their partners. The tax rate in this class is lower than in Tax Class 1.
- c. Tax Class 3: This tax class is for married couples or officially registered partners, where one partner does not work or has a lower income. The couple has the option to split the tax burden by transferring a portion of the income to the partner with the lower income, resulting in a lower tax rate.
- d. Tax Class 4: This tax class applies to married couples or officially registered partners where both partners work and have relatively balanced incomes. In this class, each partner submits a separate tax return, and the tax rate is higher than in Tax Class 3.
- e. Tax Class 5: This tax class is for married couples or officially registered partners where only one partner submits an individual tax return. The couple chooses to bear the entire tax burden in their respective individual tax calculations.
- f. Tax Class 6: This tax class applies when an individual has more than one job or receives additional income from other sources. This tax class has the highest tax rate.

In Germany, income tax is deducted directly by the employer or company and then remitted to the Finanzamt (German Ministry of Finance).<sup>25</sup> In Germany, the classification of taxes is based on percentage rates. Germany classifies tax rates into three percentages: 14%, 42%, and 45%.<sup>26</sup> The breakdown of income and tax rates is as follows:

- a. For annual income ranging from 9,000 to 54,949 euros, a tax rate of 14-42% applies.
- b. For annual income ranging from 54,949 to 260,532 euros, a tax rate of 42% applies.
- c. For annual income above 260,532 euros, a tax rate of 45% applies.

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<sup>23</sup> CNN Indonesia, 'Edhy Prabowo Buat Perusahaan Cangkang Tampung Suap Benur' (*nasional*15 April 2021) <<https://www.cnnindonesia.com/nasional/20210415004016-12-630096/edhy-prabowo-buat-perusahaan-cangkang-tampung-suap-benur>> accessed February 2024.

<sup>24</sup> Pieter Baert, 'BRIEFING EU Legislation in Progress' (2023) <[https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733648/EPRS\\_BRI\(2022\)733648\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733648/EPRS_BRI(2022)733648_EN.pdf)> accessed June 2023.

<sup>25</sup> 'KONSULAT JENDERAL REPUBLIK INDONESIA DI FRANKFURT, REPUBLIK FEDERAL JERMAN' (*Kementerian Luar Negeri Republik Indonesia*6 May 2021) <<https://kemlu.go.id/frankfurt/id/news/14126/kiat-mendapatkan-pengembalian-pajak-di-jerman>> accessed June 2023.

<sup>26</sup> Admin ZF, '3 Negara Dengan Pajak Penghasilan Tertinggi Di Dunia' (*FlazzTax*28 February 2020) <<https://flazztax.com/2020/02/28/3-negara-dengan-pajak-penghasilan-tertinggi-di-dunia/>> accessed June 2023.

In general, the mechanism of tax payment in Germany involves several steps and procedures. These steps include tax calculation, document collection, tax declaration submission, tax examination, determination of tax amount, tax bill issuance, tax payment, and further tax examination.<sup>27</sup>

Initially, taxpayers, whether individuals or legal entities, calculate the amount of tax to be paid based on their income or financial transactions. They then gather documents and information for the purpose of tax declaration submission. Taxpayers are required to submit a tax declaration that provides details of their income, deductions, and tax liabilities. Tax declarations are typically submitted annually according to the schedule determined by the tax authorities. Taxpayers must fill out tax forms and ensure that all information provided is accurate and complete.

The next step is the tax examination conducted by the German tax authorities, specifically the Finanzamt (German Ministry of Finance). The tax authorities examine the tax declarations submitted to ensure compliance with applicable tax laws. This examination may involve requests for additional information, supporting documents, or interviews.

Subsequently, the tax amount is determined based on the tax declarations submitted by taxpayers and verified by the German tax authorities. This includes income tax as well as other applicable taxes such as value-added tax or property tax. The German tax authorities will then send tax bills to taxpayers. These bills include information on the amount to be paid, the payment deadline, and payment instructions. Taxpayers are required to settle the tax bills.

Tax payments can be made through various methods, such as bank transfers, cash payments at the tax office, or electronic payments through designated systems. The final step in the sequence of tax payment mechanisms in Germany is further examination by the German tax authorities to audit the accuracy of tax payments and verify taxpayers' compliance.

### **3. Indonesian and German Regulatory Viewpoints on Dealing with Shell Corporations and Shadow Economy**

Taxation is regarded as a crucial foundation for the functioning of government operations in the life of a nation. This is due to the fact that taxes constitute the largest source of government revenue. Tax calculation is a crucial component in determining the Gross Domestic Product (GDP), which is an important indicator for measuring the performance of a country's economy. However, unrecorded shadow economy practices, such as the misuse of shell companies, result in unrecorded taxation, which cannot be included in the calculation of the GDP and has implications for data bias.

Regarding the potential tax loss in Indonesia, a study conducted in 2019, using the method of multiplying the potential shadow economy with the tax ratio, revealed that the annual

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<sup>27</sup> Amsulistiani Ensich, 'Cara Mengurus Pajak Di Jerman . CV-GEN News' (*CV-GEN News* 6 February 2023) <<https://news.cv-gen.com/cara-mengurus-pajak-di-jerman/>> accessed June 2023.

tax loss amounted to approximately IDR 56.23 trillion.<sup>28</sup> High tax rates serve as a trigger for the emergence of shadow economy activities. In order to address the issues related to the shadow economy and the misuse of shell companies as one of its forms, the Indonesian government has taken efforts to implement various strategies and measures aimed at enhancing legal compliance, especially in tax law, preventing illegal practices to increase tax compliance, and strengthening the taxation system. The government of Indonesia has intensified monitoring and auditing of companies and individuals suspected of being involved in shadow economy practices. Institutions such as the Directorate General of Taxes, the Financial Services Authority, and the Supreme Audit Agency are actively engaged in conducting comprehensive audits and examinations to uncover illegal practices and take necessary legal actions.

To strengthen regulations and compliance, particularly in tax regulations, the government has been focusing on improving the regulations related to the establishment, operations, and reporting of companies to prevent the misuse of shell companies and ensure compliance with tax obligations. Stringent regulations are being enforced, such as transparent reporting requirements, anti-money laundering provisions, and the implementation of Know Your Customer principles to accurately identify company ownership and minimize illegal practices.

Indonesia also plays an active role in enhancing cooperation with other countries in terms of financial and tax information exchange. This is aimed at uncovering shadow economy practices involving shell companies with cross-border implications. Effective information exchange can assist in identifying companies involved in shadow economy activities. Indonesia's efforts in this regard are manifested through a program called Automatic Exchange of Information (AEOI). This program aims to expand the tax base and prevent tax avoidance and erosion. AEOI is a system that facilitates the systematic and continuous exchange of taxpayer information domestically and internationally. With such a system and mechanism in place, taxpayers with assets or accounts overseas cannot evade their tax obligations, thereby reducing the shadow economy practices that have been prevalent among tax evaders.

According to the Automatic Exchange of Information Implementation Report, in 2018, Indonesia engaged in information exchange with 57 other tax jurisdictions. This indicates Indonesia's commitment to leveraging opportunities to enhance tax revenue through the utilization of AEOI.<sup>29</sup> Several data elements are exchanged, including the account owner's identity, account numbers, financial institution identity, account balances, and income derived from the account or interest. The issuance of Presidential Regulation No. 40 of 2018 on the Renewal of the Tax Administration System is expected to provide a foundation for the government to address the phenomenon of shell companies, potentially leading to a shadow economy. It is hoped that Indonesia can achieve accurate tax data to prevent shadow economy activities through tax administration improvements.

<sup>28</sup> Nanda Rezky, 'KAJIAN KEGIATAN SHADOW ECONOMY DI INDONESIA: SEBUAH STUDI LITERATUR' (2020) 6 Jurnal Akuntansi Bisnis dan Ekonomi <<https://journal.widyatama.ac.id/index.php/jabe/article/download/617/470>> accessed June 2023.

<sup>29</sup> Muhammad Dahlan, 'SHADOW ECONOMY, AEOI, DAN KEPATUHAN PAJAK' (2020) <<https://ejurnal.pajak.go.id/st/article/download/51/23/774>> accessed June 2023.

The existence of a shadow economy is not only a challenge in Indonesia but also considered a serious matter in the legal landscape of Germany. Germany recognizes the detrimental impact of the shadow economy on the economy, tax revenues, and societal well-being. The German government has devised various strategies and measures to effectively address the misuse of shell companies as one concrete form of the shadow economy. The Federal Ministry of Finance and the Federal Central Tax Office have been empowered with additional authority and resources to investigate cases of shadow economy activities. In order to tackle the misuse of shell companies as a form of shadow economy, Germany has strengthened regulations governing company formation, operations, and reporting. The country has implemented strict Know Your Customer (KYC) and Anti-Money Laundering (AML) requirements to ensure the true ownership and purpose of company formations, promoting transparency and ease of verification. Germany also mandates accurate and timely financial reporting, including disclosure of financial information, transactions, and beneficial ownership, enabling authorities to identify and scrutinize shell companies that may be used for unlawful purposes such as tax evasion. In addition to regulatory measures, Germany places significant emphasis on international cooperation to combat the shadow economy and the misuse of shell companies. The country actively participates in global initiatives, such as tax information exchange with other jurisdictions, to identify cross-border transactions and activities that may indicate shadow economy practices.

The EU legislation introduces a groundbreaking proposal that revolves around the initiative to implement a "screening" system for corporate entities within the European Union (EU). The primary objective is to prevent the misuse of shell entities for tax purposes. This system will enable corporate entities to undergo a series of criteria concerning their income, staff count, and ownership of buildings, ensuring that these entities possess sufficient substance to qualify as legitimate and beneficially driven companies. If an entity is deemed lacking in substance based on the established criteria, it will be classified as a "shell company." To counter this classification, the entity must provide additional evidence substantiating strong commercial reasons for its existence, emphasizing non-tax motivations. Failure to adequately demonstrate such reasons will result in the entity losing the tax benefits granted through bilateral tax agreements among EU member states or favorable tax treatment previously enjoyed under EU directives.

Several exceptions exist within the scope of this proposal. These exceptions include entities whose income from relevant sources, such as interest, dividends, and royalties, accounts for more than 75% of their total income. Additionally, entities with over 60% of their book value of assets located outside the EU member states for a minimum of two years or entities obtaining over 60% of their relevant income through cross-border transactions, as well as entities that have outsourced their day-to-day operational and decision-making functions.<sup>30</sup> Corporate entities must disclose information regarding their company's location, active bank accounts within the

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<sup>30</sup> "Unshell" – Rules to Prevent the Misuse of Shell Entities for Tax Purposes | Think Tank | European Parliament' ([www.europarl.europa.eu](http://www.europarl.europa.eu)) <[https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_BRI\(2022\)733648](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2022)733648)> accessed June 2023.

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European Union, the tax domicile of their director, and permanent employees of the entity. All statements must be supported by corroborating evidence.

## **CONCLUSION**

The shadow economy is a phenomenon that has sparked debates within the legal landscape of countries worldwide. Shell companies, as one form of indication of the shadow economy, are often associated with potential misuse for the purpose of tax avoidance. In Indonesia, shell companies are legally recognized and categorized as Permanent Establishments. However, from a taxation perspective, Indonesian law views shell companies as special-purpose vehicles. German law defines shell companies as "Mantelgesellschaften" or "Leere Gesellschaften" and categorizes them into three main types: anonymous shell companies, mailbox companies, and special purpose entities. Indonesia adopts a self-assessment tax system in accordance with the mandate of Article 4 of the Income Tax Law, which states that every taxpayer's income must be reported and taxed without any geographical limitations. The provisions regarding tax payment in Indonesia are regulated by Law Number 28 of 2007. In Germany, the tax system incorporates a class system based on marital status, and when it comes to income, Germany divides it into three tax brackets. To address issues related to the shadow economy and the misuse of shell companies, the Indonesian government has implemented the AEOI (Automatic Exchange of Information) program, aimed at expanding the tax base and preventing tax avoidance practices and erosion. Germany, as a member state of the EU, implements a proposal system that allows companies to be screened before obtaining tax relief benefits.

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